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EX PARTE OR LATE FILED

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December 3, 1996

RECEIVED

DEC 3 - 1996

Federal Communications Commission
Office of Secretary

EX PARTE

BY HAND
William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 96-149 - In the Matter of Implementation of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area - Notice of Proposed Rulemaking

Dear Mr. Caton:

On December 2, 1996, Alan J. Gardner (Vice President - Regulatory & Legal Affairs), Jeffrey Sinsheimer (Director - Regulatory Affairs), and Glenn Semow (Director - State Regulatory & Legal Affairs) of the California Cable Television Association, sent the attached letter via facsimile to John Nakahata regarding the Structural Safeguards Notice of Proposed Rulemaking. Copies of the letter were also sent to Commissioner Chong, Commissioner Quello, Commissioner Ness, A. Richard Metzger, Jr., Lauren J. Belvin, Daniel Gonzalez, James Casserly, and Carol Mattey. Please accept a copy of this letter for inclusion in the above-referenced proceeding.

We are submitting two copies of this notice in accordance with Section 1.1206(a)(1) of the Commission's Rules.

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Should you have any questions regarding this matter, please contact me.

Sincerely,

Donna N. Lampert

Enclosures

cc: Commissioner Chong
Commissioner Quello
Commissioner Ness
Mr. John Nakahata
Mr. A. Richard Metzger, Jr.
Ms. Lauren J. Belvin
Mr. Daniel Gonzalez
Mr. James Casserly
Ms. Carol Mattey

F1/61311.1

California Cable Television Association

Department of
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Lesla Lehtonen
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Jerome Fitch Candelaria
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Darlene M. Clark
Staff Attorney

Cynthia Walker
Regulatory Manager

December 2, 1996

John Nakahata
Senior Legal Advisor to
The Honorable Reed E. Hundt
Federal Communications Commission
1919 M Street, N.W.
Washington, DC 20554

Re: Structural Safeguards NPRM

Dear John:

In our recent meeting concerning the FCC's Structural Safeguards NPRM you requested a further explanation of the legal and economic rational for strict separation between the interLATA operations of a Bell Operating Company's 272 affiliate and the BOCs' local operations. This separation requirement was mandated by Congress because it is essential to achieve the competitive outcome envisioned by the 1996 Telecommunications Act. While Congress gave the BOCs and their affiliates the ability to jointly market local and long distances services so that the BOCs could provide "one stop shopping," it foreclosed them from providing local services through their long distance affiliates during a three year transition period. In so doing, Congress sought to balance the need to curb potential abuses of the BOCs' local exchange market power with the need to allow the BOCs' to compete on an equal footing.

Nonetheless, a number of the BOCs have interpreted the Act in a manner which undermines these structural separations safeguards. These companies argue that Section 272 of the Act, which permits the joint marketing of local and long distance service by a BOC and its long distance affiliate, actually authorizes the affiliate to provide local services in conjunction with long distance service. These companies are wrong. Furthermore, it is critical to both the interests of ratepayers and competition that the FCC implement this section of the Act as it was intended by prohibiting the BOCs' long distance affiliates from providing local services for at least the minimum three year period envisioned by the Act.

The harm which will result if the operating companies' long distance affiliates are permitted to provide local services is best illustrated in the case of PB COM, Pacific Telesis' 272 affiliate. PB COM has filed for authority in California to provide local exchange services, inter and intraLATA services and discretionary services on both a facilities and resale bases. While PB COM claims that it will have no market power in the market for local exchange services when it begins to provide service, its affiliate, Pacific Bell, certainly will. Pacific Bell has almost 100% of the local exchange market within its service territory and the lions share of the intraLATA toll market due to the absence of 1 plus dialing. In addition, only Pacific Bell has a ubiquitous network within its service territory. Finally, Pacific Bell enjoys superior brand name recognition, and currently has control of the assignment of numbers, directory listings and CPNI.

If PB COM is permitted by the FCC to provide local exchange services, it and Pacific Bell will have a common objective-- maximizing the profits of their parent, Pacific Telesis. Based upon this common objective, Pacific Bell and PB COM will have every incentive to leverage Pacific Bell's market power to benefit PB COM even if it is to Pacific Bell's detriment. If the FCC does not maintain the strict separation between Pacific Bell and PB COM that Congress intended, it will be extremely difficult for California to regulate the local exchange market effectively. California will have only two options: either it can regulate the local services of PB COM just as it regulates the local services of Pacific Bell or it can regulate PB COM like it would any other new entrant which lacks market power. The first alternative is untenable because it would result in the virtual duplication of the existing regulatory framework applicable to Pacific Bell. The second alternative is not viable because, by definition, it is wholly inadequate to protect ratepayers and nascent competition from the effects of the anticompetitive leveraging of Pacific Bell's market power.

In its application, PB COM estimates that at it will have 1 million customers after one year and 4 million customers at the end of five years, representing approximately one third of Pacific Bell's existing customer base. If PB COM is lightly regulated like other new local exchange entrants and is permitted itself to provide monopoly services either on a facilities or resale basis, PB COM and Pacific Bell will migrate Pacific Bell's most lucrative local exchange customers to PB COM just as PC COM's application demonstrates. This migration will be to the financial detriment of Pacific Bell and the vast majority of its remaining customers who have little or no competitive local exchange alternatives and must depend on Pacific Bell for local service during the transition to competition. Because Pacific Bell's earnings will decline as a result of this migration, there will be pressure to increase rates to captive customers or augment universal service funds. Furthermore, while captive customers remain with Pacific Bell and more lucrative customers are intentionally transferred to PB COM, Pacific Telesis will continue to prosper, but local competition will suffer.

If PB COM is able to provide monopoly services which previously were provided by Pacific Bell subject to price and cost safeguards, PB COM will have the freedom to pursue anticompetitive pricing strategies which will injure competition. Indeed, absent cost and pricing safeguards, PB COM will have strong incentives to offer local exchange services it obtains from the Pacific Bell at a loss in order to anticompetively leverage its way into competitive markets. Moreover, if local rates or universal service support are increased due to Pacific Bell's revenue losses, Pacific Telesis will receive compensation for any intentional losses sustained by PB COM as a result of anticompetitive pricing strategies.

Finally, Pacific Bell will have ample incentive to provide PB COM with preferential contracts for resold services in order to price squeeze competitors. These contracts may be at low rates based upon service volumes or term commitments to which other competitors can not commit. Moreover, Pacific Bell will have little incentive to enforce its contracts with PB COM should PB COM fail to perform.

Despite the harm which would result if the long distance affiliates of the BOCs are permitted to provide local services, certain BOCs have argued that the Act actually permits such activity. These companies cite as authority section 272(g)(1) of the Act which sets forth the conditions under which the BOCs' long distance affiliates may "market and sell" local exchange services. However, these companies have misinterpreted this section of the Act. Section 272(g)(1) does not permit the 272 affiliates of the BOCs to jointly provide local and long distance services. Rather, it gives them only the ability to jointly market these services. This is readily apparent when one reads section 272(g)(1) in conjunction with 272(g)(2). Section 272(g)(2) states the following:

> A Bell operating company may not market or sell interLATA services provided by an affiliate required by this section within any of its in-region States until such company is authorized to provide interLATA services in such State under section 271(d).

If "market and sell," in this section meant that the operating company could actually provide the long distance services of its affiliate, the structural separation provisions of the Act requiring a separate long distance affiliate for a minimum three year period would be meaningless. Thus, "market and sell" must mean that the operating company has the ability to jointly market its affiliate's long distance services with its local exchange services rather than the ability to jointly provide these services. Given the parallel construction of 272(g)(1) and 272(g)(2), the affiliate's ability to "market and sell" the local exchange services of the operating company asserted in 272(g)(1) must likewise be limited to jointly marketing local exchange and long distance services as opposed to jointly providing these services itself.

Indeed, this conclusion is fully supported by the Senate and Joint Conference Report. The Senate Conference Report states:

> Section 102 requires that to the extent a regional Bell operating company engages in certain businesses, it must do so through an entity that is separate from any entities that provide telephone exchange service.
>
> ...the activities required to be carried out through a separate subsidiary under this section may be conducted through a single entity that is separate and distinct from the entity providing telephone exchange service.
>
> The activities that must be separated from the entity providing telephone exchange service include telecommunications equipment manufacturing and interLATA telecommunications....

1995 Senate Report at 22-23[1]

While the Senate stated unequivocally that the long distance operations of the BOCs must be structurally separate from "any entities" providing local exchange services, it was clearly aware of "one stop shopping" opportunities open to the BOCs and their affiliates and gave them the more limited competitive tool of joint marketing. In the paragraphs immediately following those cited above, which mandate separation between the BOCs local and long distance operations, the Conference Report states:

> The Committee believes that the ability to bundle telecommunications, information, and cable services into a single package to create "one stop shopping" will be a significant competitive marketing tool. As a result and to provide parity among competing industry sectors, the Committee has included restrictions on joint marketing certain services both in section 252(d) and in new sections 255(b)(3). Under subsection 252(d) of this section the Bell operating company entity that provides telephone exchange service may not jointly market the services required to be provided through a separate subsidiary with telephone exchange service in an area until that company is authorized to provide interLATA service under new section 255. In addition, a separate subsidiary required under this section may not jointly market its services with the telephone exchange services provided

1. The Joint Conference Committee Report adopted this portion of the Senate version of the Act with without modification. See Joint Report at 152.

by its affiliated Bell operating company unless each entity allows other unaffiliated entities that offer the same or similar services to those that are offered by the separate subsidiary to also market its telephone exchange services. Id.

In permitting the BOCs and their long distance affiliates to jointly market local and long distance services but not to jointly provide these services, Congress struck the appropriate balance between the need to curb potential abuses of market power by the BOCs and the need to give the BOCs the ability to provide "one stop shopping." Congress gave the BOCs the ability to provide "one stop shopping" through joint marketing arrangements. At the same time, Congress required through structural separation that the BOCs remain the providers of local exchange services so that their long distance affiliates could not creme skim the operating companies' revenues. In addition, because the BOCs remain the providers of local exchange services, these services remain subject to the price and cost regulation necessary to deter cross subsidy and other anticompetitive behavior during the transition to a competitive market. Thus, the FCC should implement the Act as it was intended by prohibiting the long distance affiliates of the BOCs from providing local exchange services other than through a joint marketing arrangement with the BOC itself.

Very truly yours,

Alan J. Gardner
Vice President
Regulatory & Legal Affairs

Jeffrey Sinsheimer
Director Regulatory Affairs

Glenn Semow
Director
State Regulatory & Legal Affairs

cc: Commissioner Chong
Commissioner Quello
Commissioner Ness
Mr. A. Richard Metzger
Ms. Lauren J. Belvin
Mr. Dan Gonzalez
Mr. James L. Casserly
Ms. Carol Mattey